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Report of Working Group I (MSMEs) on the work of its twenty-second session (New York, 10-14 February 2014)

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I. Introduction

1. At its forty-sixth session, in 2013, the Commission requested that a working group should commence work aimed at reducing the legal obstacles encountered by micro, small and medium-sized enterprises (MSMEs) throughout their life cycle.[1] At that session, the Commission took note of the broad consensus among the participants at the second UNCITRAL colloquium on microfinance organized in Vienna in January 2013, that such a working group should be established.

2. At that same session, the Commission agreed that consideration of the issues pertaining to the creation of an enabling legal environment for MSMEs should initially focus on legal questions surrounding the simplification of business incorporation and registration. It was further agreed that other topics to be considered in the context of MSMEs at a later date included: (a) a system for resolving disputes between borrowers and lenders; (b) effective access to financial services; (c) guidance on ensuring access to credit; and (d) insolvency.[2]

3. As noted in the materials before the Commission and during its deliberations at its forty-sixth session, in 2013, in addition to reducing barriers to MSMEs entering the formal economy and thus, inter alia, helping them to maximize their economic potential, work on the simplification of business incorporation and registration could have additional salutary international effects. In particular, it was noted that an internationally recognized form of business registration could be expected to facilitate cross-border trade for MSMEs operating in regional markets, since it would provide a recognizable international basis for transactions and avoid problems that may arise because of a lack of recognition of the business form of the enterprise.[3]

II. Organization of the session

4. Working Group I, which was composed of all States members of the Commission, held its twenty-second session in New York from 10-14 February 2014. The session was attended by representatives of the following States Members of the Working Group: Armenia, Australia, Brazil, Canada, China, Colombia, Denmark, France, Germany, India, Iran (Islamic Republic of), Italy, Japan, Kenya, Mexico, Nigeria, Pakistan, Panama, Paraguay, Republic of Korea, Russian Federation, Spain, Switzerland, Thailand, Uganda and United States of America.

5. The session was attended by observers from the following States: Chile, Dominican Republic, Finland, Guatemala, Libya, Madagascar, Poland, Romania, Serbia, Uruguay and Viet Nam.

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[1] *Official Records of the General Assembly, Sixty-eighth Session, Supplement No. 17* (A/68/17), para. 321.

[2] For a history of the evolution of the topic of MSMEs on the UNCITRAL agenda, see A/CN.9/WG.I/WP.80, paras. 5-12.

[3] *Official Records of the General Assembly, Sixty-eighth Session, Supplement No. 17* (A/68/17), paras. 316-319; Note by the UNCITRAL Secretariat, Microfinance: creating an enabling legal environment for micro-business and small and medium-sized enterprises, A/CN.9/780, para. 10.

6. The session was attended by the following non-member States having received a standing invitation to participate as observer in the sessions and the work of the General Assembly: Holy See.

7. The session was also attended by observers from the following international organizations:

(a) Organizations of the United Nations system: World Bank;

(b) Invited intergovernmental organizations: International Cotton Advisory Committee, League of Arab States, Organization of American States and World Customs Organization;

(c) Invited international non-governmental organizations: American Bar Association (ABA), Centro de Estudios de Derecho Economía y Politica (CEDEP), Commercial Finance Association (CFA), Fondation pour le Droit Continental, National Law Center for Inter-American Free Trade (NLCIFT), New York State Bar Association (NYSBA) and The Association of the Bar of the City of New York (ABCNY).

8. The Working Group elected the following officers:

Chair: Ms. Maria Chiara Malaguti (Italy)

Rapporteur: Mr. Francisco Reyes (Colombia)

9. The Working Group had before it the following documents:

(a) Annotated provisional agenda (A/CN.9/WG.I/WP.80);

(b) A note by the Secretariat concerning selected activities of international and intergovernmental organizations to promote MSMEs (A/CN.9/WG.I/WP.81);

(c) A note by the Secretariat on the features of simplified business incorporation regimes found in selected States, as well as empirical information concerning their use (A/CN.9/WG.I/WP.82); and

(d) Observations by the Government of Colombia concerning the Colombian Simplified Corporation (A/CN.9/WG.I/WP.83).

10. The Working Group adopted the following agenda:

1. Opening of the session.
2. Election of officers.
3. Adoption of the agenda.
4. Preparation of legal standards in respect of micro, small and medium-sized enterprises (Simplification of business incorporation and registration).
5. Other business.
6. Adoption of the report.

III. Deliberations and decisions

11. The Working Group engaged in discussions in respect of the preparation of legal standards aimed at the creation of an enabling legal environment for MSMEs, in particular on the simplification of business incorporation and registration regimes, on the basis of Secretariat documents A/CN.9/WG.I/WP.81 and A/CN.9/WG.I/WP.82, and of the observations of the Government of Colombia in A/CN.9/WG.I/WP.83. The deliberations and decisions of the Working Group on these topics are reflected below.

IV. Preparation of legal standards in respect of micro, small and medium-sized enterprises (Simplification of business incorporation and registration)

A. Micro, small and medium-sized enterprises in the global context

12. The Secretariat highlighted certain aspects of document A/CN.9/WG.I/WP.81, which provided a non-exhaustive survey of initiatives of intergovernmental, regional and international organizations in support of MSMEs. UNCITRAL's proposed work on MSMEs could be placed in the broader context of the United Nations work on sustainable development and inclusive finance, including the preparation of the Post-2015 Development Agenda. Furthermore, as considered during the 2013 UNCITRAL colloquium on microfinance and as noted at the forty-sixth session of the Commission (in 2013) such work could contribute to reinforcing the rule of law at the country level.

13. Reference was made to United Nations General Assembly resolution 67/202, which focused on the contribution of entrepreneurship to sustainable development, calling for the creation of an enabling environment for entrepreneurs, including MSMEs, by addressing legal, social and regulatory barriers. In addition, United Nations work to promote cooperatives was noted, in particular in respect of the 2012 International Year of Cooperatives, which stressed the contribution of cooperatives to economic development and poverty eradication and highlighted that they could represent an enterprise model in those areas where the public sector was not able to meet the needs of the population.

14. As noted in A/CN.9/WG.I/WP.81, regional organizations and regional economic organizations supported MSMEs in various ways. However, policy development and the provision of technical assistance seemed to prevail over the drafting of comprehensive legislation addressing the needs and requirements of MSMEs. Among the various organizations reviewed by the Secretariat, only the Organisation pour l'Harmonisation en Afrique du Droit des Affaires (OHADA) appeared to be working towards such a legislative framework.

15. Similarly, initiatives and projects of international organizations did not seem to focus on assisting the development of new legislative models that would facilitate the establishment and operation of MSMEs in the formal economy. Attention focused mainly on reducing the existing regulatory, economic and administrative

barriers that represented a constraint on MSMEs in order to promote their formalization in the medium and long term.

16. In addition to the examples of MSME support included in document A/CN.9/WG.I/WP.81, the World Customs Organization (WCO) advised the Working Group of its Model Business Law Checklist for SMEs. The model was being developed with a view to assisting Member States in designing, modifying and reviewing customs policies and procedures from the perspective of SMEs. The WCO also informed the Working Group that a research book regarding informal trade would be issued.

17. As A/CN.9/WG.I/WP.81 concluded, the development of an internationally recognized and harmonized approach to creating the legislative infrastructure to foster the development of MSMEs had not yet been fully explored. While individual States had experienced notable success in developing such regimes domestically, little had been done in terms of establishing a means of internationalizing that success. Therefore, the mandate entrusted by the Commission to Working Group I, starting with simplified business registration and incorporation and extending to additional issues, appeared to be a natural complement to existing work being carried out globally and regionally to assist the development and growth of MSMEs.

18. The Working Group expressed its agreement with the conclusions of A/CN.9/WG.I/WP.81. It was observed that the topic of simplified incorporation had a cross-border as well as a domestic dimension, since it could provide MSMEs a recognizable international basis for transactions. For this reason, the topic was said to be relevant for both developing and developed countries and could be expected to enable MSMEs to unleash their full potential.

B. Features of simplified and other business incorporation regimes and their impact on MSMEs

19. The Working Group was also reminded of the main issues raised in document A/CN.9/WG.I/WP.82 in its consideration of features of simplified and other business incorporation regimes and how those features could be relevant to support MSMEs. It was noted that simplified corporate forms were a relatively new type of regime aimed at providing a more flexible and accessible business form for MSMEs, which could also be advantageous for enterprises of a larger size. It was observed that many different types of enterprises could benefit in several ways from the creation of simplified corporate forms, including smaller closely-held companies, family firms, joint ventures and professional service firms.

20. The comparison of different simplified corporate forms contained in document A/CN.9/WG.I/WP.82 was highlighted, noting that the different regimes were examined in respect of three main areas. First, issues of limited liability and other aspects of formation were considered, including legal personality, issues relating to disclosure of financial statements, formation requirements, and the number of founders required pursuant to each legal regime examined. The second main area of comparison focused on internal governance established in each of the legislative schemes, in particular on internal governance itself, on financial rights among owners, on the existence of freedom of contract in establishing the internal governance and on the transferability of the ownership interest. Finally, each

separate regime was also examined with a view to the fiduciary duties they required in order to protect the enterprise from abusive or excessively negligent behaviour on the part of managers.

21. Other aspects of document A/CN.9/WG.I/WP.82 were highlighted, such as the suggestion that concerns about the potential of simplified business forms for their abuse in pursuit of criminal activities could be addressed through disclosure of beneficial ownership and sharing of information domestically and internationally. In addition, possible methods of conflict resolution for participants in simplified business forms were noted, including through derivative actions or the existence of exit rules for enterprise owners to withdraw or be expelled from the business. Another approach considered for conflict resolution was the creation of specialized business courts and procedures focused on providing faster, more flexible and expert dispute resolution for participants in simplified corporate forms. Finally, the attention of the Working Group was drawn to various available statistics indicating the success of such simplified business forms in a number of different States.

General comments on the direction the work could take

22. Several general observations were made in respect of issues that could be considered by the Working Group in addressing its mandate. The view was expressed that the work, once completed, should include a list of best practices drawn from country experience in this area. In addition, it was observed that SMEs and larger enterprises were more likely to require consideration of international issues than micro-sized enterprises, which were more likely to operate in a more limited scope and thus be subject to the specific context of individual States. Other views were expressed that, although ambitious, the Working Group should consider the possible internationalization of small and micro-sized businesses, particularly in the modern electronic business era, and in respect of craftsmen and others who may add value in the production chain. The Working Group also noted that its work should be undertaken with a view to enhancing the creditworthiness of MSMEs. Finally, two intergovernmental organizations advised the Working Group of their strong interest in, and support of, the work being undertaken.

Size of the enterprise and application to specific sectors

23. Some States shared their experience in terms of simplified business forms, some of which were the result of ongoing legislative reforms, whether such efforts were intended specifically to support MSMEs, or for other reasons. In one instance, it was noted that the focus of a State's legislative reform was not based on the size of the business, but on providing appropriate measures for businesses to formalize with minimal capital requirements. Later in the life cycle of such businesses, when they became more successful, they could transition to full limited liability corporations. Other examples were given of the creation of certain categories of companies based on size and the types of business undertaken, but noting that the traditional approach to corporation law had not relied on different sizes of enterprises. In addition, it was observed that some simplified regimes have focused directly on assisting MSMEs, while others were applied to smaller enterprises only after the regimes had been developed for other purposes, yet the net result of both approaches had been positive for MSMEs and larger enterprises. States also observed that, in general, their business incorporation regime did not focus on

specific sectors of the economy. Presentations were made by two delegations evidencing that simplified business registration and incorporation had a substantial impact on increasing the registration and incorporation of micro and small businesses in their countries.

24. In general, it was agreed that although a definition of MSMEs was used in certain contexts, including in providing policy support through mechanisms such as subsidies and taxation relief, it was not necessary to approach the simplification of business incorporation with specific company size in mind. The main concern in terms of size of enterprises intended for inclusion in a simplified incorporation regime was to ensure that sole proprietors were considered for inclusion in the regime, even those that might be engaged in relatively simple business activities. It was also observed that some States offered a fairly extensive menu of different legal options to enterprises wishing to formalize, while others appeared to offer fewer alternatives, but enhanced flexibility, to entrepreneurs.

Limited liability

25. It was observed that, while limited liability was broadly available and considered to be an important incentive to include in a simplified incorporation regime, some States considered it useful to restrict limited liability to corporations possessing certain features that balanced the enterprise's obligations to stakeholders such as employees, contracting parties, investors or banks. Support was expressed to include mechanisms, such as piercing the corporate veil, to address situations where limited liability might be abused. In addition to limited liability corporations, the Working Group was encouraged to consider inciuding a regime for cooperatives in its discussions on simplified business forms, particularly given the importance of cooperatives in several States.

Online registration, single point of entry and standard articles of incorporation

26. Several States noted that online registration of businesses was quite broadly available, and that many States have dramatically reduced the time necessary for incorporation of a business through the use of electronic means. In States that require notarial services for valid business incorporation, special online conduits have been established between notaries and the relevant authorities to speed the process. A single point of entry for enterprises wishing to formalize has been established in several States; in addition, templates containing standard articles of incorporation are offered in many States to smaller businesses and those with reduced business sophistication.

Intergovernmental and cross-border collaboration and information-sharing

27. It was observed that the sharing of information on the beneficial ownership of enterprises was one method of dealing with the potential misuse of simplified business regimes for illicit purposes. Several States reported requirements for the sharing of such information stemming from either domestic legislation or international commitments. In addition, it was noted that European Union (EU) Directive 2012/17/EU (13 June 2012) required the interconnection of central, commercial and companies registers within the EU; while the information-sharing platform would allow public access, it would not be fully operational for several years.

C. Issues relevant to commencing the work

Limited liability and legal personality

28. Further to the discussion on limited liability in paragraph 25 above, the Working Group continued to explore the issue of limited liability, particularly as it related to legal personality. Limited liability was described as an important risk-reducing system that allowed entrepreneurs to take business risks without fear of failure, but it was noted that many MSMEs were currently excluded from such a protective regime and that efforts should be made to include them. There was general support for the view that limited liability and legal personality offered to MSMEs important advantages in doing business and that it was important to provide access to these advantages to such enterprises.

29. However, it was also noted that some legal regimes linked limited liability to capital requirements, while still providing for partnerships without minimum capital requirements but with no limited liability. Another legal regime allowed streamlined limited liability models for micro-business without reference to legal personality. One example was provided where an entrepreneur possessed no legal personality but could nevertheless protect certain assets from seizure by creditors. Another example was provided of a legal regime in which legal personality had become less relevant and that businesses with no legal personality could still be involved in legal actions and own property. Some interest was expressed in exploring these options as possible solutions.

30. Several delegations emphasized the importance of focusing on the nature of MSMEs and the business environment in which they must operate in order to appropriately assist them. It was noted that enterprises doing business in many legal systems were faced with a range of options from limited companies with capital requirements to limited partnerships to cnterprises with no legal personality or limited liability. It was noted that it may not be possible to find one solution for all types of enterprises, and it was suggested that the Working Group may wish to focus on different frameworks for different types of enterprises.

31. It was indicated that exceptions to limited liability varied among jurisdictions. However, it was further suggested that it was not necessary at this stage of the discussion to establish a common understanding of the principles of legal personality or limited liability.

A single model with a great deal of flexibility

32. The question was raised in the Working Group whether it would be desirable to focus in its work on a single legislative model, ensuring that it was flexible enough to cover many different types of business.

33. There was some support for the view that a single model with built-in flexibility could be appropriately adapted to all forms of MSMEs. However, it was suggested that having a single flexible model could be both complicated for micro and small businesses and a source of extra cost. Alternatively, it was suggested that it could be possible to create a continuum of different business forms (sole proprietor, partnership and limited liability company) that would accommodate

different types of entrepreneurs based on their needs and circumstances. There was some support for that view.

Model law, legislative guide or another form

34. The Working Group next considered what form its work on the preparation of legal standards in respect of MSMEs and simplified business incorporation and registration should take. It was noted that UNCITRAL texts represented a fairly broad range of types of instruments, but that the forms most suitable for the work at hand could be a legislative guide or a model law, possibly with a guide to enactment, or some combination thereof.

35. It was observed that efforts had previously been undertaken in a regional economic integration organization to create a single private limited liability company form for the region, but that such efforts had proven difficult. That experience suggested that achieving consensus on a model law could be difficult and that the preferred approach could be to prepare a legislative guide to help policymakers in States prepare regimes suitable for their local needs. An additional suggestion made reference to the same experience, but instead suggested that the Working Group should not focus on simplified incorporation, but rather on the registration of companies and the use of unique identification mechanisms to provide greater transparency and broader, more efficient sharing of information.

36. A preference was also expressed by some delegations for the preparation of a legislative guide over a model law for the reason that model laws might not be widely taken up by States, and since they were said to lack the flexibility that a legislative guide could offer through its commentary and recommendations. This flexibility was said to be particularly important in order to allow States using the legislative guide to adapt the legal approach to the local context and in a manner appropriate for the needs of MSMEs. In addition, it was noted that legislative guides were not static texts, but rather they could be organic and be added to with additional chapters when necessary.

37. A preference was also expressed by other delegations for the preparation of a model law, particularly in light of the fact that there was already an existing example (as provided in A/CN.9/WG.I/WP.83) that had proven effective and could be an appropriate starting point for discussions. It was noted that a model law need not necessarily be a rigid instrument that presented only one approach to a particular issue, but that different options could be accommodated within a single model law, and that this approach would be preferable to preparing a range of model laws from which it might be difficult to choose. It was also observed that, while legislative guides were very useful and contained an enormous amount of information, including best practices, it could be difficult for certain States to effectively use that information to prepare appropriate legislation. The preferred option in these cases could be to offer States a model law that contained the main legislative components and could be easily modified for specific use by States. It was noted that one drawback of adapting model laws to local circumstances was that it would reduce the harmonizing effect of the model law, but that at least the starting point for an adapted model law would have been a single international standard.

38. It was further suggested that the Working Group could prepare both a model law and a legislative guide in order to maximize the information provided and the

flexibility of the materials, but also to provide relatively simple solutions for States wishing to consider an existing legislative scheme rather than preparing one on the basis of information provided in a legislative guide. The Working Group agreed to take its decision on the form of the text to be prepared after it had further considered the issues that would be included in the text, as well as what the text should achieve. However, there was support for the suggestion that the Working Group should consider preparing model articles of incorporation, particularly if they were to be paired with a model law, since such texts could be very helpful for MSMEs.

Use of a possible hybrid business form approach

39. The question was raised to what extent the Working Group wished to build upon hybrid business forms in order to achieve positive results in terms of simplifying business incorporation and registration to assist MSMEs. It was observed that it might not be necessary to adopt a hybrid business form in order to accommodate these needs, and that the experience of some States indicated that other business forms could be accommodated by adapting existing company law rather than creating a specific hybrid form. However, there was support for the view that hybrid business forms could prove useful even in legal systems where less flexible approaches to business forms were usually taken. It was further stated that hybrid business forms could offer an opportunity for States to move beyond existing business forms that may not adequately support MSMEs in order to create different forms that accomplished that goal.

40. In further explanation of an existing hybrid business form, it was noted that the legal regime was based upon rules from both the common law and continental law traditions, incorporating favourable aspects of both partnership and company law. Freedom of contract in the system described was very broad, and the internal governance system was very flexible, accommodating simple one-person forms as well as more complex structures. In response to the view expressed that less flexible business forms satisfied stakeholders in the market and protected third parties and creditors, it was noted that hybrid business forms were also able to provide adequate protection for creditors and third parties dealing with the enterprise.

Transparency in respect of beneficial ownership

41. The Working Group also considered the issue of ensuring transparency in respect of beneficial ownership of closely-held corporations. The question was raised whether this issue intended to focus on protecting creditors and other stakeholders dealing with the corporation, or whether the intention was to prevent money-laundering, terrorist activity and other illicit activities involving these types of corporations. It was suggested that the issue should be considered from both perspectives, noting that substantial work in the latter area had been done by the Financial Action Task Force and the G8 (see also paragraphs 26 to 30 of A/CN.9/WG.I/WP.82). It was suggested that these issues were of a regulatory nature, but that the Working Group should remain mindful of them in its work. It was further noted that carefully constructed legal requirements for incorporation in some States could also serve the purpose of providing transparency in such circumstances.

Possible alternative approaches for micro-businesses

42. Further to the discussion on possible legislative models aimed at the simplification of incorporation for MSMEs in paragraphs 34 to 38 above, the Working Group considered in greater detail possible topics that could be included in such models. Issues raised for the consideration of the Working Group included matters such as incorporation procedures, contents of the formation document of the entity, registration of the business and proof of its existence. Concern was expressed that, while appropriate for the creation of a simplified incorporation regime for small and medium-sized business, several of these issues were possibly too burdensome to meet the needs of micro-entrepreneurs wishing to formalize their businesses. There was support for the view that micro-businesses required a model that was less complex and more specifically designed to meet its needs. It was said that the greatest needs of micro-entrepreneurs were the ability to set up their business quickly and easily, and to be able to access credit to grow their businesses. Similarly, it was noted that in many States, micro-businesses tended to be sole owners and it was questioned whether it was appropriate to expect a micro-business to seek to be incorporated under such detailed rules, particularly when resorting to them would require some education and business sophistication. It was felt that requiring micro-businesses to incorporate, even in a simplified fashion, could work against bringing such businesses into the formal market. There was support in the Working Group for these views.

43. Suggestions were made that the Working Group could approach its mandate by treating separately the categories of small entrepreneurs and micro-entrepreneurs. It was said that this could accommodate the different needs of these two groups, while still providing each with the possibility of joining the formal economy and of starting a business with limited assets. Consistent with the mandate of the Working Group, the treatment of micro-entrepreneurs could focus on simplified registration, at least as a first step.

44. However, it was suggested that imposing a rigid distinction between micro and small business would not assist in the creation of an enabling legal environment for MSMEs, which should allow for business growth in a progressive cycle, from micro to small and medium. Furthermore, even micro-businesses, including those that are sole proprietors, would need basic formalities in order to establish themselves.

45. In order to maintain a uniform approach by the Working Group to the creation of a legislative model to simplify incorporation for micro and small entrepreneurs, an alternative approach was suggested focusing on issues common to both these types of businesses. These issues included limited liability, legal personality, the protection of third parties and creditors dealing with the enterprise, registration of the business, sole ownership and internal governance issues. Freedom of contract was suggested as an additional topic, since in some countries, entrepreneurs had limited flexibility in the way they could establish and conduct their businesses.

46. Reference was made to several national legislative models applicable to micro and small businesses that might be considered relevant by the Working Group in its further consideration of how best to approach its mandate. For example, it was possible in some States for entrepreneurs to segregate property in certain circumstances, despite not possessing true legal personality. Relevant delegations agreed to submit to the next session of the Working Group documents presenting the

distinctive features of those models with a view to facilitating the understanding of the Working Group in respect of how such features could provide alternative forms of organization for micro and small businesses.

Business registration

47. In keeping with its discussion in paragraphs 42 to 46 above, the Working Group was of the view that emphasis should be given in its work to the importance of business registration. It was noted that business registration was key as it was required of enterprises of all sizes wishing to formalize, and that there was no need to treat registration of micro-businesses differently, provided that registration of enterprises could be accomplished quickly and at a low cost. It was also observed that business registration was not a goal unto itself, but that it was intended to provide transparency and a means to establish recognition for a business to enter into a formal environment. While this information would be shared among the relevant authorities for the purposes of taxation and other regulatory measures, it was noted that registration would also assist micro-businesses to obtain financing and access to government assistance programmes such as subsidies and reduced-cost services. However, it was also observed that registration would not necessarily be available to or desirable for all micro-businesses and single person entrepreneurs and that the Working Group should continue to consider additional measures that could help these businesses to formalize.

48. One delegation related its successful experience with recent and significant changes to its business registration system, which other delegations referred to as the most sophisticated in the region. The system was modernized to permit both electronic and manual registration, and procedures were greatly simplified as well as being provided quickly and at no cost. Another delegation described its more formal model of business registration, which was accomplished through a notary who carefully verified the information, which could then be relied upon to provide transparency for all third parties in their dealings with the business. Moreover, despite its formal nature, business registration could be accomplished in a few days.

49. The Working Group agreed to request the Secretariat to prepare a document for its next session in which best practices in respect of business registration would be examined for further discussion by the Working Group. The following issues were highlighted as being relevant to that future consideration:

(a) Identification of the minimum information necessary to register;

(b) Establishment of a unique identification number for businesses, which would not conflict with global initiatives in this regard;

(c) Data protection and confidentiality;

(d) Ability to search for a unique business name;

(e) Easily-updated information;

(f) Identification of who would have access to the information, including credit institutions and the public;

(g) Consider interconnectivity among relevant authorities, including that information need only be provided once by the user;

(h) Low or no cost;

(i) Quickly accomplished;

(j) Minimal and simple procedures to follow;

(k) A record of the history of the business should be maintained;

(l) A standard model form should be provided electronically to the user and could possibly be used for the creation of company by-laws;

(m) Provide the user with the necessary means to conduct business, such as providing a tax identification number; and

(n) Provide proof of existence of the business.

50. In addition, in respect of anti-money-laundering, anti-terrorism and the prevention of other illicit activity, it was agreed that other international guidelines and recommendations should be taken into account.

Capital requirements for incorporation

51. It was observed that the requirement of minimum capital for incorporation was an issue on which there was not agreement in all quarters. Although it was acknowledged that too high a capital requirement could be considered too harsh, the view was reiterated that minimum capital requirements were necessary and reasonable in order to offset the provision of limited liability to an enterprise and to signal its commitment to the sustainability of the business. It was further noted that even in States where incorporation with no capital requirement was possible, an enterprise nonetheless required assets in order to function. Another view questioned the need for limited liability, observing that a business owner in that State would obtain access to credit most easily by agreeing to unlimited personal liability.

52. However, there was support in the Working Group for the opposite view that the requirement of minimum capitalization of an enterprise was not an appropriate method of protecting third parties dealing with the business, and could both increase costs and unnecessarily keep businesses out of the formal economy. Other means that did not impose significant costs on businesses were suggested as better able to protect creditors, such as the creation of standards of conduct including good faith, transparency of business information, fiduciary responsibilities and the ability to pierce the corporate veil. One particular problem related to establishing minimum capital requirements was said to be the difficulty of quantifying an appropriate amount, and the rigidity inherent in making such a choice. There was broad agreement with the view that the modern trend was to move away from minimum capital requirements. One delegation quoted World Bank research indicating that minimum capital requirements hindered business development and growth, as well as failing to fulfil the regulatory functions for which they were intended.

53. It was observed that in keeping with the modern trend away from strict minimum capital requirements for incorporation, certain legal regimes had been established that took into account the difficulty of smaller enterprises to meet those requirements early in their life cycle, and had adopted a system of progressive capital requirements. Several States reported having as one of their incorporation models a system whereby an enterprise could incorporate with no or a nominal capital requirement, but that each year it operated, the company was required to set

aside a certain percentage of its profit, or a set amount each year, until its reserves reached a certain amount such that it could be said to be, or to amount to, a fully capitalized corporation. Another State reported a variation on the progressive capitalization approach, which adopted a limited liability partnership model that used a similar transitional phase to allow the business to grow over the course of several years until it reached a minimum reserve level, during which time there were restrictions on the distribution of dividends and sharing of profits. Reasons for creating additional flexibility in terms of minimum capital requirements included the fact that in deciding whether to deal with the company, creditors were more likely to focus on the assets of the company than its liabilities, and that forum-shopping was taking place by companies wishing to operate in a State, but not wishing to incorporate in that State and meet its minimum capital requirements.

54. A concern was raised that even progressive capital requirements could negatively impact small enterprises starting up, since the first three years of their life cycle were the most critical, yet the enterprises would be required to progressively build up their reserves during that period in spite of their possible financial fragility. It was reiterated that the Working Group should continue to be mindful of the fact that different sizes of businesses, from micro to small to medium, could require different solutions in terms of the issue of minimum capital requirements.

55. Additional possible alternatives to a minimum or progressive capitalization requirement to protect third parties dealing with such enterprises were also suggested. For example, accounting rules that require certain transparency could be used, as could specific rules relating to the distribution of the profits of the company. Another solution used by a State was to require no minimum capital, but to require public disclosure, possibly by way of a registry, by the business of any decision it took in respect of its capital, including setting aside certain amounts or having variable capital reserves. In addition, it was said that the issue of transparency in accounting and the auditing of financial statements could assist in the protection of third parties, as could the establishment of credit bureaus, be they established by the State or by private interests. Other elements that could be used to protect third parties were said to be the establishment of a supervisory role by company registries; the establishment of specialized agencies to supervise businesses; monitoring corporate governance; setting interest rates; and ensuring that secured transactions and insolvency laws permitted negotiated contractual protections.

56. It was noted that a State with progressive capitalization requirements for one of its types of incorporation provided notice to third parties by requiring such corporations to use a specific suffix in its legal name. Another possible method of protecting third parties that was under consideration by a State was to allow a corporation to have limited liability without capitalization requirements, provided that it was limited to a maximum turnover — an approach that would again differentiate on the basis of the size of the business.

57. Other methods of protecting third parties dealing with companies with minimum or no capitalization was linked to the issues outlined in paragraph 52 above, and were said to have been especially effective in developing States. Rather than establishing ex ante requirements which could impose costs on companies, the State could instead intervene ex post in order to discipline fraudulent behaviour or

irregular use of the company. In addition, it was observed that certain ex ante requirements could also be effective in preventing such behaviour from occurring, and that insolvency procedures could also be invoked to assist third parties.

58. The Working Group was reminded that the size of the informal economy in States that were members of the Organization for Economic Cooperation and Development was quite modest in comparison to figures available on the size of the informal economy in developing countries. It was said that bringing actors in the informal economy into the formalized system was therefore mainly a problem in developing countries, and it was suggested that providing a scheme for simplified business incorporation presented one option for enterprises wishing to make the transition into the formalized economy.

59. It was further observed that the Working Group may wish to take note that not all third parties dealing with the enterprise could be protected in the same way. It was noted that high standards of public disclosure in terms of an enterprise's finances might be sufficient to protect voluntary creditors of a company, but that such mechanisms may not sufficiently protect involuntary creditors, nor may minimum capital requirements or obligatory capital reserves. It was suggested that in such cases, States may wish to establish better mechanisms for satisfying the claims of involuntary creditors so as to avoid putting an unnecessary burden on the business.

Dispute resolution

60. It was noted that issues in respect of dispute resolution did not only concern the resolution of disputes among partners or as between partners and managers of the business, but related also to conflicts arising between the business and third parties, such as creditors or clients. In the case of the former, it was noted that conflicts involving business partners and managers were often resolved in courts, which could be problematic in developing States due to a lack of experience in dealing with such matters, expensive court fees and overburdened court dockets. One method of dealing successfully with this problem in both developing and developed countries had been to establish special courts to deal with such disputes.

61. In respect of disputes involving the business and third parties, several delegations highlighted the need for micro and small businesses to have access to fast and inexpensive dispute resolution mechanisms rather than dealing with the formal court system. Experiences were shared by various delegations as to their approach in resolving disputes concerning micro and small businesses and in providing consumer protection. Several examples concerned the establishment of specialized institutions for the resolution of disputes resulting from financial claims. In one case, it was observed that the institution could not render binding decisions, but relied on voluntary compliance by the financial intermediary at fault; cases of non-compliance were publicized, resulting in a strong negative effect on the commercial reputation of the party at fault.

62. It was also suggested that there was a need to address conflict arising between MSMEs and third parties in situations of financial distress of the business. This was said to require a simplified regime of insolvency that would meet the needs of MSMEs, a matter currently being considered in UNCITRAL's Working Group V. One State provided an example of an expedited regime that it had for micro and

small business, aimed mainly at encouraging refinancing arrangements. The Working Group agreed on the importance of providing simplified and low-cost dispute resolution procedures to MSMEs, with a particular focus on methods such as arbitration and mediation, including online dispute resolution.

Governance issues

63. The Working Group next considered the issue of the internal governance of enterprises. It was generally agreed that freedom of contract should be the guiding principle in terms of establishing the internal organization of a company, although it was noted that very unsophisticated micro and small businesses could find resort to this principal a challenge in setting up their businesses. Two examples of possible exceptions to absolute freedom of contract in this regard were said to be rules regarding the prevention of conflicts of interest of managers of the company and certain rules relating to the law of agency. It was noted that freedom of contract was a desirable goal, but that micro and small businesses might have difficulty with the transaction costs of establishing their own internal governance and of complying with it, and that standard forms could also be useful in this regard.

64. It was also noted that some forms of business association were quite rigid and required certain information in the articles of association from which there could be no deviation. It was said that such rules were necessary for very practical reasons, for example, to establish how revenues of the company should be distributed. Moreover, very strict rules were also required for some publicly-traded companies in order to prevent instability that could damage the economic system.

D. Next steps

65. The Working Group agreed that it had been able to consider a number of important issues key to developing its work on preparing legal standards on simplified business incorporation and registration, and considered what work would have to be accomplished prior to its next session in order to make progress in fulfilling its mandate. In addition to the document setting out best practices in respect of business registration which the Secretariat had been requested to prepare for the next session of the Working Group (see paragraph 49 above), a second document was to be prepared in advance of that session by States outlining their experience in respect of alternative approaches to the challenges of simplified incorporation and supporting MSMEs (see paragraph 46 above). In addition to those materials, the Secretariat was requested to prepare a template on simplified incorporation and registration containing contextual elements and experiences linked to the mandate of the Working Group, to provide the basis for drafting a possible model law, without discarding the possibility of the Working Group drafting different legal instruments, particularly, but not exclusively, as they applied to MSMEs in developing countries. This template could include provisions on limited liability, legal personality, registration and proof of existence of companies, incorporation procedures, capital requirements or alternatives thereto, accounting and transparency, and liability of those who represent the company.

V. Possible future work

66. The Working Group acknowledged and welcomed the Commission's mandate relative to the establishment of an enabling legal environment to facilitate the life cycle of MSMEs, beginning with the implementation of simplified rules of registration, incorporation and operation of such enterprises, in addition to other topics such as financial inclusion, including mobile payments, access to credit, alternative dispute resolution and simplified insolvency rules.